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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
McLEODUSA TELECOMMUNICATIONS SERVICES, INC.	)	CC Docket No. 98-84
	)	
	)	
Petition for Preemption of Nebraska Public Service Commission Decision Permitting Withdrawal of Centrex Plus Service by U S WEST Communications, Inc.	))))	

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OFFICE OF THE SECRETARY

REPLY OF McLEODUSA TELECOMMUNICATIONS SERVICES, INC.

David R. Conn
William A. Haas
Richard S. Lipman
McLeodUSA Telecommunications Services, Inc.
6400 C Street, SW, P.O. Box 3177
Cedar Rapids, Iowa 52406-3177
(317) 298-7055 (Tel)

Andrew D. Lipman
Richard M. Rindler
Swidler & Berlin, Chtd.
3000 K Street, N.W., Suite 300
Washington, D.C. 20007-5116
(202) 424-7500 (Tel)

Counsel for
McLeodUSA Telecommunications Services, Inc.

Dated: July 27, 1998

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EXECUTIVE SUMMARY

The Reply of McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") may be summarized as follows:

The Withdrawal of Centrex Has the Effect of Prohibiting Competitive Entry: The Commission's *Texas Preemption Order* makes clear that a state need not erect an absolute bar to competitive entry in order to violate section 253 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 ("1996 Act"). Since the order of the Nebraska Public Service Commission ("PSC") has prevented McLeodUSA and other resellers from using their preferred platform to provide service in Nebraska, and thereby effectively precluded these carriers from entering the Nebraska local exchange market altogether, the Commission should act to preempt the anticompetitive consequences of the Nebraska PSC's order.

The Facts Support Commission Action on the Petition: Taken together, the positions advocated at the Nebraska PSC hearing on Centrex withdrawal, the Petition filed by McLeodUSA, and the supporting comments filed by interested parties in this proceeding provide sufficient facts to justify preemption of the *Nebraska Order*. U S WEST's Opposition attempts to mischaracterize the record in this proceeding in a transparent effort to distract the Commission from the patently anticompetitive consequences of the *Nebraska Order*.

The Nebraska PSC Has Not Enforced the Procompetitive Provisions of the 1996 Act: In its *Local Competition Order*, this Commission expressed concerns about the anticompetitive implications of service withdrawals, and instructed state commissions to "scrutinize the implications" of proposed withdrawals. Rather than heeding this advice, however, the Nebraska PSC overlooked any competitive obligations under *federal law* and limited its consideration to an analysis of the withdrawal and grandfathering under *state law*. This Commission must step in where the Nebraska PSC did not, to ensure that the provisions of section 251 are adequately enforced.

The Commission Should Act Now to Preempt the *Nebraska Order*: The Commission should not defer consideration of the present Petition pending resolution of the appeal of the *Nebraska Order*. As a preliminary matter, section 253 "requires" the Commission to preempt state legal requirements that restrict competitive entry. Moreover, prior to the release of this Commission's *Texas Preemption Order*, there was uncertainty whether the provisions of section 253 would prohibit a state legal requirement that foreclosed only one means of entering a market. With the release of that decision, however, it became clear that restrictions on even a single means of entry could be preempted under section 253. With the knowledge that the Commission may provide the relief needed pursuant to section 253, McLeodUSA has filed its Petition.

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REPLY OF
McLEODUSA TELECOMMUNICATIONS SERVICES, INC.

McLeodUSA Telecommunications Services, Inc. ("McLeodUSA"), by undersigned counsel, respectfully submits its Reply to the Oppositions and Comments filed by interested parties in the above-captioned proceeding. The majority of parties filing in response to McLeodUSA's Petition for Preemption ("Petition") have expressed strong support for the Petition. McLeodUSA urges the Commission to act expeditiously to preempt the anticompetitive barrier imposed by the 1996 decision of the Nebraska Public Service Commission ("PSC").[1]

I. THE WITHDRAWAL OF CENTREX HAS THE EFFECT OF PROHIBITING COMPETITIVE ENTRY IN THE NEBRASKA LOCAL EXCHANGE MARKET.

The majority of commenters agree with McLeodUSA's assertion that there need not be an absolute bar to competitive entry to justify Commission action pursuant to section 253 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 ("1996 Act"). As the Association for Local Telecommunications Services ("ALTS") states, "[A] restriction that

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[1] *In the Matter of McLeod Telemanagement, Inc.; MCI Telecommunications Corp.; and AT&T Communications of the Midwest, Inc. vs. US West Communications, Inc.*, Docket Nos. FC-1252, FC-1253, FC-1254, Opinions and Findings (Neb. PSC Nov. 25, 1996) ("*Nebraska Order*").

prevents a carrier from providing service by the means, or over the facilities, or via a particular entry strategy that it desires (particularly a strategy, like resale, that is specifically contemplated by the Act) must be preempted."[2] Similarly, MCI comments that "[t]he Nebraska PSC's approval of U S WEST's withdrawal of Centrex service has produced the same result as an express prohibition on provision of telecommunications services in the Nebraska market."[3]

Many of these supporting commenters point to the Commission's *Texas Preemption Order* for the proposition that section 253 requires the Commission "to preempt not only express restrictions on entry, but also restrictions that indirectly produce that result."[4] WorldCom and ALTS accurately note that the availability of Centrex for resale is all the more essential for competitive entry in rural states such as Nebraska, "where the deployment of network facilities is far more difficult and resource-intensive than in more densely-populated, urbanized areas."[5] As described in the Petition and in further detail below, the Nebraska PSC's sanctioning of Centrex withdrawal has proven sufficient to keep McLeodUSA (and other carriers) out of Nebraska even as McLeodUSA entered every other U S WEST state bordering Nebraska. For the purposes of section 253, then, the withdrawal of Centrex approved in the *Nebraska Order* is as anticompetitive as any blanket prohibition on resale that could have been imposed by the Nebraska PSC.

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2 ALTS, at 3.

3 MCI, at 3.

4 *Petitions for Declaratory Ruling and/or Preemption of Certain Provisions of the Texas Public Utility Regulatory Act of 1995*, CCB Pol 96-13 96-14, 96-16, 96-19, Memorandum Opinion and Order, 13 FCC Rcd 3460, 3480 (1997) ("*Texas Preemption Order*"), at ¶ 41.

5 WorldCom, at 3. *See also* ALTS, at 3-4 ("One of the best ways the Commission can jump start [competition in rural markets] is to preempt the Nebraska PSC decision and pave the way for McLeodUSA and others to begin the provision of competitive services in Nebraska.").

II. THE FACTUAL RECORD SUPPORTS THE NEED FOR PROMPT COMMISSION ACTION ON THE PETITION.

U S WEST's Opposition mischaracterizes the record in this proceeding. It is of necessity forced to to so, since U S WEST itself concedes that "the Commission clearly has the right and duty to preempt state regulatory decisions which have the anti-competitive consequences described in Section 253 of the 1996 Act."[6] According to U S WEST, "McLeod has presented no meaningful facts in support of its preemption Petition."[7] Even a cursory review of the record, however, reveals the serious flaws of U S WEST's unsupported statement. The facts underlying the Petition are clear: (i) Centrex resale is a highly desirable means of entering the local exchange market because it provides a feature-rich package that can easily be customized;[8] (ii) Centrex was chosen by McLeodUSA in 1993 as its preferred platform for the delivery of resold local exchange services in all of its states;[9] (iii) only three days before the 1996 Act was signed into law, U S WEST notified the Nebraska PSC of its intention to withdraw and grandfather Centrex;[10] (iv) while declining to adopt a broad prohibition on withdrawal and grandfathering, this Commission expressed concern about the "anticompetitive effects" and directed state commissions to "ensure that procedural mechanisms exist for processing complaints regarding incumbent LEC withdrawals of services;"[11]

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6 U S WEST, at 3.

7 U S WEST, at 2.

8 Petition, at 3.

9 *Id.* at 2, 10.

10 *Id.* at 2.

11 *Id.* at 9 (*quoting Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499,

(v) failing to heed the Commission's direction, the Nebraska PSC officially sanctioned the withdrawal of Centrex without ever considering the competitive implications of such withdrawal as required by the 1996 Act;[12] (vi) Centrex withdrawal is inconsistent with typical industry practice to withdraw "obsolete" service offerings;[13] (vii) U S WEST has not made a comparable replacement product available for resale in Nebraska;[14] and (viii) although McLeodUSA has successfully entered and is vigorously competing in all of the U S WEST states bordering Nebraska and in several other U S WEST states through the resale of Centrex services, it has been unable to enter the Nebraska market in the same manner simply because of the barriers erected by the *Nebraska Order*.[15]

The record before the Nebraska PSC clearly demonstrated all the "facts" which U S WEST claims to be lacking. Although U S WEST claims that the withdrawal of Centrex Plus in Nebraska was because "the product was not successful in the new competitive environment,"[16] the testimony presented by U S WEST's witness before the Nebraska PSC relied on a desire to prevent "arbitrage" as the primary reason.[17] Indeed, U S WEST recently confirmed that it primarily withdrew Centrex in Nebraska "in order to address the problem of unfair price arbitrage that could have occurred with

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15978 (1996) ("*Local Competition Order*"), at ¶ 968).

12 Petition, at 8-10, 14.

13 *Id.* at 11.

14 *Id.* at 11, 27.

15 *Id.* at 2.

16 U S WEST, at 4.

17 (Nebraska PSC Transcript of Hearing, Formal Complaints No. 1252, 1253, and 1254, May 30, 1996, at 106-09.) (hereinafter "*Hearing Transcript*").

the continued offering of the service."[18] Although U S WEST sees Centrex Plus resale as an arbitrage "threat," established Commission policies lead to a different conclusion. The Commission has considered arguments such as those advanced by U S WEST for the past twenty years, and has concluded that resale inhibits price discrimination and drives prices toward cost by making arbitrage possible.[19]

U S WEST's strong desire to prevent resale is even more apparent when additional facts are examined. U S WEST's own witness testified that Centrex Plus is priced above cost.[20] U S WEST's then argues, however, that arbitrage is "usually based on undercutting telephone rates containing implicit subsidies," and that its withdrawal of Centrex Plus was justified as an attempt to be "procompetitive."[21] Such convoluted logic must be rejected by the Commission. If the problem U S WEST postulates exists – and McLeodUSA does not concede that it does – the proper response is to *eliminate* the implicit subsidies in the competing products in question, not to withdraw the product that competitors use to compete with the subsidized product.

U S WEST also told the Nebraska Commission that Centrex Plus would be replaced with a "more feature rich and competitive product."[22] The alleged replacements for Centrex Plus, however,

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18 U S WEST Response to McLeodUSA Data Request, Nebraska PSC Application No. C-1830, July 6, 1998 (provided as Attachment A).

19 *In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Domestic Public Switched Network Services*, Report and Order, 83 FCC 2nd 167, 175 , ¶¶15-17 (1980); *Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities*, Report and Order, 60 FCC 2nd 261, 299, ¶76 (1976).

20 *Hearing Transcript*, at 133.

21 U S WEST, at 7.

22 *Hearing Transcript*, at 105.

again demonstrate the anticompetitive nature of the action taken. U S WEST now offers two products, Centrex 21 and Centrex Prime, in Nebraska. Centrex 21, designed for smaller users, cannot be efficiently used by McLeodUSA because it limits customers to 50 station lines, and does not contain operationally essential functionalities such as Centrex Management System and Automatic Route Selection that are available with Centrex Plus.[23] Centrex Prime, recently introduced by U S WEST in Nebraska and apparently intended to be the "large user" version of Centrex, contains the following explicit resale restrictions:

> Centrex *PRIME* Service is available as a business system to single businesses for resale by certified resellers. Centrex *PRIME* Service is only available for resale to the same class of customer which the Company sells the service. For example, no reseller of service shall subscribe to Centrex *PRIME* station lines or associated features and provide those services to a residence customer.[24]

By restricting resale only to "single businesses," this language requires the purchase of a separate Centrex *PRIME* system for each individual end-user. This is essentially the same restriction which the Commission has already held to be an unlawful restriction on resale with respect to Southwestern Bell's resale of Centrex service.[25] Further, the explicit restriction on resale of the service to residential customers is apparently designed specifically to prevent McLeodUSA from doing what it has done with Centrex Plus: provide a competitive alternative to residential customers. McLeodUSA currently provides service to thousands of residential customers, using

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[23] U S WEST Communications Exchange and Network Services Catalog for Nebraska, Section 9, Pages 22-23.

[24] *Id.* at Section 9, Page 40, Release 2.

[25] *Texas Preemption Order*, 13 FCC Rcd 3561, at ¶ 218.

Centrex resale as the underlying service. U S WEST's attempt to prevent this is virtually unprecedented; McLeodUSA knows of no other instance in which a telephone company has prevented a *residential* customer from being served on a *business* platform. In fact, Centrex Plus was available to any Nebraska customer who was willing to pay for it, regardless of whether U S WEST considered that customer to be a business or a residence customer.[26]

The other commenters in this proceeding have reinforced the factual basis of McLeodUSA's Petition. MCI and WorldCom note that Centrex is an essential service for many competitors because it provides an effective means of entering the local market and providing the benefits of competition to consumers.[27] Moreover, Frontier Telemanagement, Inc. and Advanced Telecommunications, Inc. (collectively, "the Joint Filers") support the factual basis of McLeodUSA's claim that the absence of Centrex resale deters competitive entry. They state quite clearly that the *Nebraska Order*'s sanctioning of U S WEST's anticompetitive action "has substantially undermined the Joint Filers' ability to provide competitive telecommunications services in Nebraska by withdrawing the platform each Joint Filer could use to provide service to its customers."[28] Finally, the membership survey information provided by the Telecommunications Resellers Association ("TRA") confirms that resellers have effectively been deterred from entering the Nebraska market. Specifically, the TRA points out that "only one TRA resale carrier member reported that it was providing, or attempting to provide, local service in Nebraska, which stands in sharp contrast to the nearly 40 states in which

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[26] *Hearing Transcript*, at 133.

[27] *See* MCI, at 3-4; WorldCom, at 2-3.

[28] Joint Filers, at 2.

multiple TRA resale carriers are active at the local level."[29] The Commission should therefore view U S WEST's claim regarding an absence of facts as no more than a "red herring" intended to distract from the flawed logic and anticompetitive impact of the *Nebraska Order*. Given the strong factual foundation already underlying McLeodUSA's Petition, the additional points raised by supporting commenters, and U S WEST's own concession that the Petition raises issues "of major consequence,"[30] the Commission should act in the context of this Petition to address the clearly anticompetitive impact of the *Nebraska Order*.

III. THE NEBRASKA PSC BREACHED ITS DUTY TO ENFORCE THE PROVISIONS OF THE 1996 ACT IN ISSUING THE *NEBRASKA ORDER*.

The majority of commenters concur with McLeodUSA's conclusion that "U S WEST clearly intended to limit the availability of [Centrex] to competitors who would soon seek to enter the Nebraska local exchange market."[31] MCI observes that "Congress could not have envisioned a situation where ILECs are allowed to get around the procompetitive provisions of the Act by employing these kind of tactics."[32] WorldCom adds that "the only argument that U S WEST could

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[29] TRA, at 2-3 (*citing* TRA, "Member Survey of Local Competition," at 2, 4 (April, 1998).

[30] U S WEST, at 3. U S WEST asserts, however, that the Petition is "a particularly poor vehicle" for analyzing these issues because it allegedly suffers from an "almost total absence of facts." *Id.* at 9. Of course, as discussed above, U S WEST's limited "analysis" of the factual foundation of the Petition is severely flawed.

[31] Petition, at 19.

[32] MCI, at 6.

muster [in support of withdrawal] is that Centrex provides competitors with the ability to provide a relatively inexpensive and flexible service offering to the public."[33]

By contrast, U S WEST's Opposition fails to offer any sound justification for its actions, focusing instead upon the theory that the Nebraska PSC has properly sanctioned U S WEST's actions and has made sure that grandfathered Centrex service is available to existing customers.[34] U S WEST ignores the fact that even if grandfathering may have been permissible under federal and state law, the Nebraska PSC had a duty under federal law to examine the competitive effects of service withdrawal as well. As TRA highlights, this Commission has "made clear its expectation that State regulators would scrutinize the 'implications' of any such withdrawal."[35] Yet the Nebraska PSC overlooked this charge in limiting its consideration of the withdrawal to an analysis of grandfathering and discrimination provisions under *state law*.[36] Indeed, the Nebraska PSC still does not recognize its obligation to ensure that section 251 is enforced, claiming in its recent comments that McLeodUSA's argument to the PSC was unpersuasive because it "did not demonstrate that the withdrawal of Centrex Plus was contrary to *Nebraska law*."[37] The Nebraska PSC's continuing failure to acknowledge that a competitive analysis is needed under *federal law* – together with the fact that McLeodUSA and other carriers have been unable to enter the Nebraska market as a result

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[33] WorldCom, at 4.

[34] U S WEST, at 5.

[35] TRA, at 4 (*quoting Local Competition Order,* 11 FCC Rcd at 15978, ¶ 968).

[36] As McLeodUSA noted in the Petition, the anti-discrimination provisions under state law are more forgiving than those imposed by section 251 of the 1996 Act. Petition, at 15, n. 35.

[37] Nebraska PSC, at 2 (emphasis added).

of the *Nebraska Order* – require that this Commission preempt the Nebraska PSC's decision and thereby ensure that the provisions of section 251 are enforced.

IV. PROMPT COMMISSION ACTION ON THE PETITION IS JUSTIFIED AND WARRANTED.

In contrast to the majority of commenters in this proceeding, the Nebraska PSC and U S WEST attempt to dissuade the Commission from acting by pointing to the pending appeal of the *Nebraska Order* in the Nebraska Supreme Court.[38] U S WEST goes so far as to claim that the reasoning behind the *Nebraska Order* "must be, except in the most extraordinary circumstances, reviewable only in the proper state court pursuant to state law."[39] The Nebraska PSC argues that "it would be prudent for the [Commission] to hold this matter in abeyance until the Nebraska Supreme Court issues its ruling."[40]

These opponents of the Petition miss the mark badly. While it is true that arguments have been made upon appeal of the *Nebraska Order* to the state supreme court, this Commission has independent authority – in fact, an obligation – to ensure that the provisions of federal law are enforced. Section 253 of the 1996 Act provides that the Commission "shall" preempt any state statute, regulation, or legal requirement that prohibits or has the effect of prohibiting competitive entry.[41] Indeed, the Commission has previously found that section 253 "*requires* us to preempt not

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38 Nebraska PSC, at 1; U S WEST, at 3-4.

39 U S WEST, at 3.

40 Nebraska PSC, at 2.

41 47 U.S.C. § 253(d) (1996).

only express restrictions on entry, but also restrictions that indirectly produce that result."[42] Since the Commission is entrusted with interpreting and implementing the resale obligations set forth in section 251(c)(4) of the 1996 Act,[43] section 253(d) clearly authorizes *and* directs the Commission to preempt any state legal requirements that conflict with the pro-competitive federal mandate in section 251(c)(4). It is immaterial to the present proceeding whether the Nebraska Supreme Court can review and overturn the *Nebraska Order* "pursuant to state law," as U S WEST claims. The Commission has the independent jurisdiction and the Congressionally-imposed duty to see that the states do not interfere with, or impair the effectiveness of, any of the 1996 Act provisions governing competitive entry.

Prior to the Commission's October 1997 *Texas Preemption Order*, there was uncertainty whether the provisions of section 253 would prohibit a state legal requirement that foreclosed only one means of entering a market.[44] McLeodUSA, AT&T, and MCI were therefore forced to protect

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42 *Texas Preemption Order*, 13 FCC Rcd at 3480, ¶ 41 (emphasis added). *See* U S WEST, at 3 (stating that "the Commission clearly has the right *and duty* to preempt state regulatory decisions which have the anti-competitive consequences described in Section 253 of the 1996 Act") (emphasis added).

43 47 U.S.C. § 251(c)(4) (1996). *See also Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 794, n.10 (8th Cir. 1997) (finding that the Commission is expressly authorized to promulgate rules addressing the "prevention of discriminatory conditions on resale"), *cert. granted*, *AT&T Corp. v. Iowa Utils. Bd.*, 118 S.Ct. 879 (1998).

44 The Texas Public Utility Commission had argued that carriers could negotiate for resale terms and conditions other than those contained in Southwestern Bell's restrictive tariff, and that the restriction therefore did not present a barrier to entry. *See Texas Preemption Order*, 13 FCC Rcd at 3561, ¶ 217. Indeed, prior to the *Texas Preemption Order*, the Commission had not squarely faced the question of whether a prohibition on only one means of entry could be considered a barrier to entry under section 253. Instead, the Commission had previously considered total bans on entry into a particular exchange or locality, or bans that prevented competitors from offering a particular kind of service (*e.g.*, payphone services). *See, e.g.*, *Silver Star Telephone Company, Inc. Petition for*

their interests and preserve their rights to challenge the *Nebraska Order* by appealing to the Nebraska court. Once the *Texas Preemption Order* was released, however, the Commission clarified that preventing competing carriers from operating "in the same manner in which they operate in other states" due to a resale restriction "'has the effect' of prohibiting the ability of any entity to provide a telecommunications service, *i.e.*, centrex service, through resale in violation of the provisions of section 253(a) of the Act standing alone."[45] With the knowledge that the Commission may provide the relief needed pursuant to section 253, McLeodUSA filed its Petition. Under these circumstances, the Commission should not defer consideration of this Petition.

Preemption and Declaratory Ruling, CCB Pol 97-1, Memorandum Opinion and Order, 12 FCC Rcd 15639 (1997); *California Payphone Association Petition for Preemption of Ordinance No. 576 NS of the City of Huntington Park, California Pursuant to Section 253(d) of the Communications Act of 1934*, CCB Pol 96-26, Memorandum Opinion and Order, 12 FCC Rcd 14191 (1997); *Classic Telephone, Inc.*, CCB Pol 96-10, Memorandum Opinion and Order, 11 FCC Rcd 13081 (1996).

[45] *Texas Preemption Order*, 13 FCC Rcd at 3561-3562, ¶ 220.

V. CONCLUSION

For the reasons set forth herein and in the Petition itself, McLeodUSA respectfully requests that the Commission grant the relief requested by preempting the *Nebraska Order*.

Respectfully submitted,

Andrew D. Lipman
Richard M. Rindler
Swidler & Berlin, Chtd.
3000 K Street, N.W., Suite 300
Washington, D.C. 20007-5116
(202) 424-7500 (Tel)

Counsel for
McLeodUSA Telecommunications
Services, Inc.

David R. Conn
William A. Haas
Richard S. Lipman
McLeodUSA Telecommunications
Services, Inc.
6400 C Street, SW, P.O. Box 3177
Cedar Rapids, Iowa 52406-3177
(317) 298-7055 (Tel)

Dated: July 27, 1998

245959.1

ATTACHMENT A

State Of Nebraska

McLeodUSA

DATA REQUEST

DATE: 07/06/98

DOCKET NO: Application No. C-1830

REQUEST NO: 01 - 0001

WITNESS: Simpson, Lori

REQUEST:

Explain the rationale for U S WEST's withdrawal of Centrex plus service from new customers in Nebraska on February 5, 1996, three days before the Telecommunications Act of 1996 became effective.

RESPONSE:

U S WEST withdrew Centrex Plus service from new customers in Nebraska in order to address the problem of unfair price arbitrage that could have occurred with the continued offering of the service. U S WEST also withdrew its Centrex Plus service from the market in Nebraska because the service was not meeting the needs of large and medium-sized business and government end-user customers, the customer base for which the service had been designed.

Respondent: Al Bergman, Manager

CERTIFICATE OF SERVICE

I, Jolanda Tedford, hereby certify that a copy of the foregoing **REPLY OF MCLEODUSA TELECOMMUNICATIONS SERVICES, INC., Docket No. 98-84** was sent to each of the following parties by U.S. mail, postage prepaid and as otherwise specified below on this 27th day of July, 1998.

SEE ATTACHED SERVICE LIST

Jolanda Tedford

Jolanda Tedford

SERVICE LIST FOR DOCKET NO. 98-84

*** Hand Delivery*

Magalie Roman Salas**
(Original + 12 copies)
Secretary
Federal Communications Commission
1919 M. Street, N.W.
Washington, D.C. 20554

ITS (1)**
1231 20th Street, N.W.
Washington, DC 20554

Janice Myles (1+ diskette)**
Common Carrier Bureau
1919 M Street, N.W.
Room 544
Washington, DC 20554

Chairman William Kennard**
Federal Communications Commission
1919 M Street N.W.
Washington DC 20554

Commissioner Susan Ness**
Federal Communications Commission
1919 M Street N.W.
Washington DC 20554

Commissioner Harold Furchtgott-Roth**
Federal Communications Commission
1919 M Street N.W.
Washington DC 20554

Commissioner Michael Powell**
Federal Communications Commission
1919 M Street N.W.
Washington DC 20554

Commissioner Gloria Tristani**
Federal Communications Commission
1919 M Street N.W.
Washington DC 20554

Don Stenberg
Nebraska Attorney General
2115 State Capital
Lincoln NE 68505

Robert R. Logsdon, Executive Director
Nebraska Public Service Commission
300 The Atrium
1200 N Street
Lincoln NE 68509

Frank E. Landis
Vice-Chairman
Nebraska Public Service Commission
300 The Atrium
1200 N Street
Lincoln NE 68509

A. L. Bergman
US West Communications
1314 Douglas on the Mall
14th Floor
Omaha NE 68102

Honorable Lowell C. Johnson
Chairman
Nebraska Public Service Commission
300 The Atrium
1200 N Street
Lincoln NE 68509

Mark P. Trinchero
James Blitz
Keith L. Kutler
Davis Wright Tremaine LLP
1155 Connecticut Avenue, N.W., Suite 700
Washington, D.C. 20036

Robert J. Aamoth
Joan M. Griffin
Andrea D. Pruitt
Kelley Drye & Warren LLP
1200 19th Street, N.W., Fifth Floor
Washington, D.C. 20036

Kecia Boney
Lisa B. Smith
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20554

Emily M. Williams
Association for Local Telecommunications Services
888 17th Street, N.W. Suite 900
Washington DC 20006

Charles C. Hunter
Catherine M. Hannan
Hunter Communications Law Group
1620 I Street, N.W., Suite 701
Washington DC 20006

Robert B. McKenna
US West Communications, Inc.
1020 19th Street, N.W.
Suite 700
Washington DC 20036

Catherine R. Sloan
Richard L. Fruchterman III
Richard S. Whitt
David N. Porter
1120 Connecticut Avenue, N.W.
Suite 400
Washington DC 20036